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June 7, 1996

BACKGROUNDER: ELECTRICITY RATES

Report Highlights

- Advisory Committee analysis shows that its recommendations for a competitive generation market will likely result in lower wholesale electricity prices than would occur with the status quo.

- Financial obligations relating to Ontario Hydro's outstanding debt could be offset by the end of the year 2005 -- without assistance from taxpayers.

How the analysis was carried out

The Advisory Committee conducted analysis to determine whether three objectives could be achieved simultaneously:

- providing lower wholesale electricity prices;
- eliminating Ontario Hydro's debt within a reasonable period of time; and,
- ensuring publicly-owned companies pay full taxes and dividends.

The Advisory Committee picked January 1, 1999 for its analysis to allow time to set up the competitive wholesale market. On that date, Ontario Hydro would be succeeded by a financial holding company called the Ontario Hydro Acceptance Corporation (OHAC).

OHAC would immediately transfer Ontario Hydro's assets and a portion of its long-term debt to new publicly-owned companies. Each of the new companies would be assigned a level of debt that allowed it to maintain a strong credit rating. The remaining, or overhanging, debt would remain with OHAC.

These new companies would all operate in a commercial manner, and each would have its own independent board of directors, with separate balance sheets and income statements.
OHAC would receive payments from the new companies for items such as interest, grants equivalent to full taxes and dividends. Essentially, the companies would pay all the same taxes and government-imposed charges paid by private companies.

In turn, OHAC would manage its portion of the Ontario Hydro debt and some other expenses. It would use any extra revenues to offset the financial obligations relating to Ontario Hydro's outstanding debt.

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The analysis used information from Ontario Hydro as well as a financial model for comparison. It did not address the impacts of changes in the distribution sector or full retail competition or asset sales -- although the Advisory Committee believes these additional factors would likely lead to new efficiencies and create further benefits for customers.

The Wholesale Rate

The current wholesale rate of electricity (which includes generation and transmission costs) averages six cents per kilowatt hour, and Ontario Hydro is committed to maintaining this average rate until the year 2001. In its analysis, the Advisory Committee assumed that initially, the competitive market price to generators for electricity would be three cents per kilowatt-hour (possibly rising to four cents by 2005). Using this assumption, the Advisory Committee's analysis calculated that the wholesale price in a competitive market would be lower than in the status quo scenario, even taking into account all other charges.

The Advisory Committee recommends a temporary charge for all users of the transmission system to provide additional revenue for the OHAC to pay down the overhanging Ontario Hydro debt. This stranded asset charge would be eliminated by the end of 2006 once the financial obligations relating to Ontario Hydro's outstanding debt are offset.

Two of the Advisory Committee scenarios included a general efficiency improvement of three per cent a year from base case levels -- or 23 per cent by 2005. Experts with experience in restructuring for competitive markets suggested this is a conservative estimate of reductions that might be expected in a more challenging competitive environment.

Impact on Ontario's Electricity Rates

All the scenarios tested by the Advisory Committee found that the wholesale price of electricity would drop from six cents in 1999 to at least 5.72 cents by 2005 at which point it will drop even further -- to either 4.45 or 5.45 cents in 2006 when the stranded asset charge is no longer needed.

Impact on Ontario Hydro's debt

The base case assumptions show that Ontario would have a long-term debt of about $28-billion at the end of 1998 (the 1994 debt is about $31.5-billion). The scenarios tested showed it would be possible to offset the financial obligations relating to the Ontario Hydro's outstanding debt by the end of the year 2005. After 2005, the only Ontario Hydro debt being serviced by ratepayers would be the portion of Ontario Hydro's debt that was assigned to the companies created from Ontario Hydro assets. These companies would service this debt as a routine cost of business.